

Message Text

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PASS TREASURY AND FEDERAL RESERVE

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SUBJECT: BELGIAN EXTERNAL POSITION AT YEAR END

REF: BRUSSELS 10875

1. SUMMARY. BELGIAN FRANCS HAVE CONTINUED THEIR "REFLOW"
INTO THE LOCAL MONEY MARKET. THE FRANC IS COMFORTABLY CLOSE
TO ITS POST-OCTOBER PIVOT RATE IN DM, AND THE NATIONAL BANK
HAS RELAXED INTEREST RATES TO A LIMITED DEGREE. FOR 1976 AS
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A WHOLE, THE BELGIUM-LUXEMBOURG ECONOMIC UNION IS LIKELY TO
HAVE A MODEST DEFICIT (12-15 BILLION BF) ON CURRENT ACCOUNT.
THIS IS DUE TO MAINLY CYCLICAL FACTORS, BUT STRUCTURAL ASPECTS
ARE ALSO SIGNIFICANT. EXTERNALLY, THE 1977 OUTLOOK FOR
THE BF WITHIN THE SNAKE LARGELY DEPENDS ON FINANCIAL
DEVELOPMENTS IN WEST GERMANY AND THE NETHERLANDS. INTERNALLY,

INFLATION, WHILE MODERATING, STILL EXCEEDS THAT OF WEST GERMANY, AND SO CONTINUES AS A MAJOR CONCERN. THE ECONOMIC SLUMP IN THE INDUSTRIALIZED COUNTRIES IS ALSO CAUSE FOR INCREASING UNEASINESS, PARTLY BECAUSE BELGIUM MAY STAND TO SUFFER MORE THAN SOME OTHERS. THIS TREND PLUS STILL WORSENING UNEMPLOYMENT WILL MEAN THAT BELGIAN OFFICIALS WILL BE PUSHING HARDER THAN EVER NEXT YEAR IN INTERNATIONAL FORUMS FOR MORE ECONOMIC STIMULATION BY THE LARGER COUNTRIES IN ORDER TO SPARK REVIVAL HERE. END SUMMARY.

2. THE REFLOW OF BELGIAN FRANCS INTO THE LOCAL MONEY MARKET SINCE LAST OCTOBER'S "MINI-REVALUATION" OF THE WEST GERMAN MARK HAS CONTINUED TO BUOY THE BF'S PARITY VIS-A-VIS ITS SNAKE PARTNERS AND THE MAJOR FLOATING CURRENCIES. ASIDE FROM A WIGGLE OR TWO DURING THE GOVERNMENT'S RECENT INTERNAL POLITICAL DIFFICULTIES, THE FRANC HAS REMAINED ALMOST STATIONARY JUST BELOW ITS NEW PIVOT RATE IN DM. THE NATIONAL BANK (BNB) HAS GRADUALLY RELAXED RATES ON VARIOUS DISCOUNT FACILITIES, BUT THE MAIN DISCOUNT RATE REMAINS AT 9 PERCENT. SHORT-TERM INTEREST RATES HAVE RESPONDED ONLY SLUGGISHLY. THEY ARE CURRENTLY AROUND 10 PERCENT FOR THREE TO TWELVE MONTH MONEY WITH RELATIVELY HIGH LIQUIDITY AND LOW DEMAND. BANKING SOURCES BELIEVE THAT SHORT-TERM RATES MAY, IN FACT, HAVE BOTTOMED OUT; INCREASED BORROWING BY THE TREASURY TO FUND THE BUDGET DEFICIT AND BY SOME QUASI-GOVERNMENTAL AGENCIES COULD MOVE THEM UP AGAIN SOMEWHAT AFTER THE FIRST OF THE YEAR.

3. AS EXPECTED, THE UNWINDING OF SPECULATIVE POSITIONS HAS ALLOWED THE BNB TO RECONSTITUTE MUCH OF THE RESERVES LOST LIMITED OFFICIAL USE

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DURING THE PERIOD JULY-SEPTEMBER. ITS FECOM DEBT IS FULLY PAID AND FOREIGN CURRENCIES ON HAND TOTAL 81 BILLION BF AS OF DECEMBER 20 (BALANCING CURRENCIES PLUS OTHER LIQUID ASSETS AGAINST SHORT-TERM LIABILITIES, THE BANK'S POSITION IS CURRENTLY PLUS BF 95 BILLION, THE HIGHEST FIGURE SINCE LAST FEBRUARY). BNB OFFICIALS ESTIMATE THAT ITS FOREIGN RESERVES WILL BE DOWN AROUND BF 28 BILLION BY YEAR'S END, COMPARED TO THE END OF 1975.

4. FOR THE FIRST NINE MONTHS OF THE YEAR, THE BELGIUM-LUXEMBOURG ECONOMIC UNION (BLEU) CURRENT ACCOUNT BALANCE ON A PAYMENTS BASIS IS IN DEFICIT BY 26.6 BILLION BF. THIS REFLECTS MAINLY CYCLICAL FACTORS, PARTICULARLY HEAVY INVENTORY RESTOCKING OF BELGIAN INDUSTRY IN EARLY 1976. FOR THE YEAR AS A WHOLE, BNB FORECASRERS ARE CAUTIOUSLY OPTIMISTIC THAT THIS DEFICIT WILL NOT GROW AND THAT IT MIGHT EVEN SHRINK TO ABOUT BF15 BILLION. ONE REASON FOR THIS CONFIDENCE IS THAT EXPORT PERFORMANCE HAS IMPROVED IN RECENT MONTHS;

IN OCTOBER, EXPORTS EXCEEDED IMPORTS FOR THE FIRST TIME THIS YEAR, PUSHING THE EXPORT GROWTH RATE OVER THE FIRST 10 MONTHS OF THE YEAR TO PLUS 20.2 PERCENT. THE B/P CAPITAL ACCOUNT IS NEAR EQUILIBRIUM.

5. ON A TRANSACTIONS BASIS, BNB OFFICIALS PREDICT A CURRENT ACCOUNT DEFICIT OF BF 20-23 BILLION. THIS IS MORE PESSIMISTIC THAN THE MOST RECENT OECD ESTIMATE (ABOUT BF 12 BILLION). THE CURRENT UPSWING IN EXPORTS COULD, HOWEVER, PRODUCE A YEAR-END TRANSACTIONS DEFICIT SOMEWHERE BETWEEN THESE, PERHAPS ALSO AT BF 15 BILLION, ACCORDING TO THESE OFFICIALS.

6. DESPITE THESE ENCOURAGING SHORT-TERM TRENDS, BNB AND OTHER GOVERNMENT ANALYSTS RECOGNIZE THAT THE ECONOMY'S PERSISTENT (ALBEIT STILL SMALL) DEFICIT ON CURRENT ACCOUNT OVER MOST OF THE PAST TWO YEARS ALSO REFLECTS STRUCTURAL FACTORS. CHIEF AMONG THESE IS THE DETERIORATION OF TERMS OF TRADE IN THE BELGIAN STEEL INDUSTRY. THE CONCOMITANT LIMITED OFFICIAL USE

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TROUBLES OF THE LUXEMBOURG STEEL SECTOR ADD TO THE TREND; THE GRAND DUCHY, ONCE A NET CONTRIBUTOR TO THE BLEU IN B/P TERMS, IS NOW, FOR THE TIME BEING AT LEAST, A NET DEBTOR.

7. THE 1977 OUTLOOK FOR THE BF WITHIN THE SNAKE IS PROBLEMATIC. BNB OFFICIALS SAY THAT THEIR DUTCH COLLEAGUES EXPECT A CURRENT ACCOUNT SURPLUS OF 6 BILLION GUILDERS IN 1976; THE BELGIANS ARE FAR FROM CONFIDENT THAT THE DUTCH WILL BE ABLE TO "EXPORT" ALL THIS SURPLUS, AND THUS BELIEVE THAT SPECULATION ON THE GUILDER COULD UNSETTLE SNAKE MARKETS DURING THE YEAR. THE BNB IS ALSO UNEASY ABOUT GERMAN INTENTIONS AFTER WHAT THEY CHARACTERIZE AS THE "DICTAT" OF OCTOBER ON THE DM REVALUATION. BNB OFFICIALS WITH WHOM WE HAVE SPOKEN BELIEVE THAT THE FRG'S ACTION AT THAT TIME, HELD BY THEM TO HAVE BEEN MOTIVATED BY THE NEEDS OF INTERNAL MONETARY POLICY, COULD BECOME THE FIRST OF A SERIES OF SUCH MINOR ADJUSTMENTS WITHIN THE SNAKE WHICH MIGHT, ACCORDING TO THIS ANALYSIS, ENCOURAGE ANTICIPATORY SPECULATION ON THE DM AND THUS SERVE ULTIMATELY TO SCUTTLE THE ARRANGEMENT.

8. INTERNALLY, INFLATION REMAINS A MAJOR CONCERN. IN TERMS OF KEY SNAKE AND TRADING RELATIONSHIPS, BELGIAN PRICES ARE STILL RISING FASTER THAN THOSE OF WEST GERMANY. GOVERNMENT AND BNB OFFICIALS ARE ENCOURAGED, HOWEVER, BY THE BETTER-THAN-EXPECTED PERFORMANCE OF CONSUMER PRICES IN 1976 (PLUS 7.5 PERCENT ON AN ANNUAL BASIS). THE EFFECT OF THE RECENT OPEC PRICE INCREASES IS A QUESTION MARK, BUT SHOULD BE CUSHIONED SOMEWHAT IF THE FRANC RETAINS ITS PRESENT STRENGTH AGAINST THE DOLLAR (PREVIOUS PRICE CONTRACTS WILL CONTINUE

TO APPLY FOR SOME TIME, IN ANY CASE). INDUSTRIAL WAGE INCREASES IN 1976 WERE LOW IN REAL TERMS, AND THERE IS CONSIDERABLE OPTIMISM THAT THIS WILL CONTINUE IN 1977 (SEE BRUSSELS 12582). ON THE OTHER HAND, A CONTINUING ECONOMIC SLUMP IN THE INDUSTRIALIZED COUNTRIES COULD HAVE A GREATER ADVERSE EFFECT ON BELGIAN PRODUCTION AND TERMS LIMITED OFFICIAL USE

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OF TRADE THAN IN MANY OTHER COUNTRIES (THE THEORY IS THAT BELGIAN INDUSTRY, GENERALLY AN INTERNATIONAL PRICE-TAKER, DOES BEST IN AN ECONOMIC UPTURN WHEN IT CAN CHARGE PREMIUM PRICES IN RETURN FOR THE FAST DELIVERY FOR WHICH IT IS RENOWNED). WITH STEADILY WORSENING UNEMPLOYMENT AS WELL (CURRENTLY 9.4 PERCENT), BELGIAN OFFICIALS THUS CAN BE EXPECTED TO PUSH HARDER THAN EVER NEXT YEAR IN THE EC, OECD AND OTHER FORUMS FOR MORE ECONOMIC STIMULATION BY THE LARGER COUNTRIES, PARTICULARLY GERMANY AND THE U.S., IN ORDER TO SPARK REVIVAL HERE.RENNER

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